Property Assessed Clean Energy

In a matter of just over a year, Property Assessed Clean Energy programs and their progeny have spread across the United States with 15 states passing enabling legislation and many others debating similar bills. California and Colorado started the trend in 2008 with AB 811 and HB 1350, respectively.

Enabling legislation expands traditional uses of land secured financing by authorizing local units of government to issue revenue bonds to raise capital; the capital is made available to consenting homeowners within the local unit of government's jurisdiction to purchase renewable energy systems or to make energy efficiency upgrades to their home or business. Through a special assessment attached to the property, the costs of such improvements are repaid over a period of years on the property tax bill and transfers with the property in the event of a sale.

PACE programs facilitate adoption of renewable energy technology and energy efficiency improvements by overcoming two significant barriers to entry: first, the up-front capital; and second, the payback period. Upfront capital costs frequently serve as a barrier to entry. Generally, and especially while credit is difficult to find, property owners do not have the resources to pay the relatively high costs of a renewable energy system or energy efficiency upgrades. PACE programs allow property owners to voluntarily contract with the local unit of government to pay for the upgrades.

The payback period needed to make renewable energy and many energy efficiency upgrades economically attractive has often been outside the reach of traditional loan programs. Traditional home equity loans are limited to five to ten years, which often don't allow the increased payment to be offset by the energy savings. Depending on the size of the loan, the PACE payments can be made for a period up to twenty years which allows the energy savings to exceed the cost. In addition, many people have been hesitant to make significant renewable energy and energy efficiency investments in their property because of the likelihood of selling the property before the cost savings are realized. PACE programs operate like traditional land secured financing that allows the special assessment to remain with the property in the event of a sale. With the expansion of land secured financing to include PACE programs, two significant barriers to wide spread market adoption have been removed.

States have used land secured financing for over a hundred years to fund public improvement projects such as sidewalks, water works or building public parks that are for *public use or benefit*. With the increased awareness of the scarcity of energy resources, the continued degradation of the environment and the economic challenges presented by reliance on fossil fuels, the definition of what constitutes a *public benefit* naturally expands to include projects that reduce energy consumption. Most states that have passed PACE legislation have included specific statutory language to expand the definition of public benefit to include the adoption of renewable energy and energy efficiency improvements.

Comments for HB No. 5640, Committee on Great Lakes and the Environments
Prepared by Eric M. Jamison of the Great Lakes Environmental Law Center
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As Michigan, and the country, focus on reducing energy consumption, PACE programs will play an integral role in making the transition. Buildings account for almost 40 percent of energy consumption in the United States. PACE programs encourage existing building owners to invest in improvements that will reduce the buildings' energy consumption. In addition many states, including Michigan, also have Renewable Portfolio Standards (RPS) requiring the production of certain percentages of energy from renewable sources by certain target dates. PACE programs may provide a potential aggregation point for states with RPS, as participating property owners will be producing some of their energy from renewable sources thereby facilitating the states RPS.

In uncertain economic times PACE programs offer a low risk, win-win economic development tool. Property owners are justifiably hesitant to invest in their properties; PACE programs mitigate much of the risk through its cost negative potential and because it is attached to the property and not the property owner. PACE legislation will drive economic development, manufacturers will need to produce the renewable energy equipment, contractors will have to install the equipment and materials, inspectors will need to inspect the work, professional staff will need to administer the programs.

In 2007, $24 billion left the state of Michigan to pay for energy resources—coal, oil, natural gas, and uranium—that cannot be produced locally. Even a modest one percent increase in energy efficiency would keep $240 million in the Michigan economy annually, create thousands of jobs for Michigan workers and help our residents and businesses save money on energy.

Answers to concerns from Banking and Financial Industry

A) PACE liens are like all other tax liens; a senior tax lien is a governmental power used to further a valid public purpose.

"This is not a new power nor one that is used infrequently. Unless the public purpose is deemed invalid or the law unconstitutional, there is no legal basis for limiting government from exercising its taxing power… [T]he placement of super senior special tax or assessment liens is an exceptionally common practice throughout the United States. The lending, underwriting, appraising, and insuring system in this country already accepts these types of liens as standard practice. PACE liens can be accommodated in exactly the same manner."[1]

B) The risk to private lenders is extremely limited.

"Although PACE assessments are senior to private debt, only delinquent amounts are subject to foreclosure. Like all land-secured property taxes, the remainder of the assessment remains as a lien on the property to be paid over time by subsequent property owners. If the delinquent assessments are secured by a senior lien, a subordinate private lender may protect its lien by paying the delinquent assessment amount (which will typically be a nominal amount compared to the outstanding balance of the private mortgage) and adding the amount of any such protective advance to the amount of its loan." [2]

C) The seniority of the PACE lien to that of first mortgage debt is critical to the development of a PACE bond market. The result of a subordinate lien would create problems with buyers, rating agencies and material bond administration. Letter from Barclays Capital dated [3]:

"[T]here would be little to no meaningful bond buyer interest in pari passu or subordinated PACE liens and therefore the PACE bond market would be highly unlikely to develop....We have come to this conclusion for the following reasons:

1) Rating Agencies View Seniority of Special Assessment Bonds as Requirement for PACE Bond Marketability: Standard & Poor's US Public Finance has published a criteria framework for its ratings of bonds backed by special tax assessments (Criteria for Special Purpose Districts, dated June 14, 2007)...Given the rating agency stated opinions, it is highly likely that subordinated/pari passu PACE Special Assessment Bonds will be rated as non-investment grade and therefore will have limited buyer appeal while also demanding high interest rates.
2) Bond Administration: There is no practical or cost-effective way for County tax collectors, administrators, fiscal agents, or bond trustees to manage a pari passu/subordinate PACE lien...the costs of any new set of procedures and mechanisms for this unique new process would be expensive and would make any such bonds prohibitively expensive to administer, even if the capital markets had interest."

[1] http://pacenow.org/documents/Legal_Finance_Q&A.pdf
[2] Cisco De Vries, Renewable Funding LLC, and Christopher Lynch, Jones & Hall, Bloomberg Law.
[3] Letter by director Chris Moriarty, Barclays Capital to Fir Tree Partners September 19, 2009.

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